APB Staff Paper

Summary of the Main Changes in the New ISAs (UK and Ireland)

This paper has been prepared to assist those seeking to understand the main changes that have recently been made to the International Standards on Auditing (ISAs) (UK and Ireland). Revised ISAs (UK and Ireland) were issued in October 2009 and apply to audits of financial statements for periods ending on or after 15 December 2010.

The description of the changes made is not exhaustive and reference to the ISAs (UK and Ireland) themselves is necessary to obtain a full understanding of them.

October 2009

Summary of the Main Changes in the New ISAs (UK and Ireland)

Contents

Background

New International Standards on Auditing (ISAs) (UK and Ireland) were issued in October 2009 and apply to audits of financial statements for periods ending on or after 15 December 2010.

The new ISAs (UK and Ireland) incorporate the clarified ISAs issued by the International Auditing and Assurance Standards Board (IAASB). Where necessary, APB has augmented the international standards with additional requirements to address specific UK and Irish legal and regulatory requirements[1]; and additional guidance that is appropriate in the UK and Irish national legislative, cultural and business context. This additional material is clearly differentiated from the original text of the international standards by the use of grey shading. A list of the ISAs is given in the Appendix.

The IAASB's "Clarity Project" was designed to improve the overall readability and understandability of ISAs through structural and drafting improvements, including:

- Describing an objective for each ISA,
- Separating the requirements in each ISA from the application material,
- Clarifying the obligations imposed on auditors by the requirements of the ISAs, including eliminating possible ambiguity about the requirements an auditor needs to fulfil arising from the use of the present tense in the guidance to the extant ISAs,
- Improving the overall readability and understandability of the ISAs through structural and drafting improvements, and
- Reducing the complexity of the existing ISAs – this was seen as being especially important to smaller audit firms with limited technical resources.

There is an increase in the number of requirements in the clarified standards as some of the material that was previously included as 'present tense guidance' is now elevated to requirements.

As part of the process the APB undertook when consulting on whether the new ISAs should be adopted it performed an evaluation of the impacts of them on audit work effort[2]. This suggested that the new ISAs that were likely to have the greatest impacts overall on auditor work effort were the revised versions of:

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[1] APB's supplementary regulatory requirements are mostly included in two supplementary standards: ISA (UK and Ireland) 250 Section B, "The Auditor's Right and Duty to Report to Regulators in the Financial Sector," and ISA (UK and Ireland) 720 Section B, "The Auditor's Statutory Reporting Responsibility in Relation to Directors' Reports." Two other regulatory supplementary requirements are included in ISA (UK and Ireland) 402, "Service Organisations," paragraph 9(e) relating to consideration of statutory reporting responsibilities in respect of accounting records; and ISA (UK and Ireland) 570, "Going Concern," paragraph 17-1 relating to disclosure of the period considered by those charged with governance when assessing whether the entity is a going concern.

[2] The results of this evaluation are presented in more detail in the APB's October 2008 Consultation Paper, "Consultation on Whether UK and Irish Auditing Standards Should be Updated for the New

ISA 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

ISA 550 Related Parties

ISA 600 Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)

Both revised ISA 540 and ISA 550 have an increased focus on management's processes and stipulate audit procedures that are not in the extant ISAs.

The revised ISA 600 clarifies how the risk model underpinning the ISAs applies in a group context. In particular, there are significant new requirements relating to the relationships between the 'group engagement team' and 'component auditors' and communications between them. Consequently the impact is expected to be most significant on audits where group components are audited by different teams, particularly for large transnational group audits. Because of this the impact on small group audits is likely to be small as the same engagement team often audits all group components.

Staff Paper

This paper has been prepared by the staff of the APB to assist those seeking to understand the main changes that have been made in the ISAs (UK and Ireland). The description of the changes made is not exhaustive and reference to the standards themselves is necessary to obtain a full understanding of them.

The Auditor's Reporting Standards

APB has not adopted ISA 700, "Forming an Opinion and Reporting on Financial Statements," as issued by the IAASB. It has instead issued a clarified version of the recently revised ISA (UK and Ireland) 700, "The Auditor's Report on Financial Statements," which addresses the requirements of company law and also provide for a more concise auditor's report, reflecting feedback to APB consultations. The main effect of this is that the form of UK and Ireland auditor's reports may not be exactly aligned with the precise format of auditor's reports required by ISA 700 issued by the IAASB. However, ISA (UK and Ireland) 700 has been designed to ensure that compliance with it will not preclude the auditor from being able to assert compliance with the ISAs issued by the IAASB (see paragraph 5 of ISA (UK and Ireland) 700).

For the UK and Ireland, requirements and guidance relating to modification of the auditor's report are currently included in ISA (UK and Ireland) 700 (Revised). Those matters are excluded from the clarified version of that standard as they are covered in:

International Auditing Standards." This is available in the Publications/Exposure Drafts section of the APB's website (www.frc.org.uk/apb).

ISA 705 Modifications to Opinions in the Independent Auditor's Report, and

ISA 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

The APB has adopted ISAs 705 and 706 with a small amount of supplementary guidance (e.g. to draw attention to the auditor's legal obligations with regard to making a statement when ceasing to hold office). This is not expected to lead to a significant change in practice regarding modifications of auditor's reports.

Standards that have been 'Clarified' but not Revised

It is not practicable to set out here a detailed analysis of all the specific changes and 'new' requirements elevated from the current guidance material. For some auditors these changes will not necessarily translate directly into changes in audit procedures to be performed as:

- some audit firms have taken the view that the current ISA (UK and Ireland) guidance reflects the proper application of the existing standards, and have accordingly already incorporated it in their audit methodologies,
- some audit teams will already be undertaking procedures that correspond to the new requirements added as 'improvements' to the existing ISAs (UK and Ireland), and
- many of the additional requirements are conditional and will not apply to all audits.

However, auditors should not assume that their current approaches will necessarily be compliant with the standards that have been clarified but not revised. It is important to have an understanding of all the clarified ISAs (UK and Ireland) and to consider whether changes to the audit approach are needed.

Standards that have been Revised

In addition to clarifying all of the ISAs, 12 of the ISAs underlying the ISAs (UK and Ireland) have also been revised and two new ISAs introduced (ISA 265 which addresses communicating deficiencies in internal control, and ISA 450 which addresses the evaluation of misstatements).

A summary of the main changes in the revised standards that are expected to impact audit procedures is set out below. This is not a comprehensive analysis of all the changes to the standards and auditors need to read the standards themselves and obtain an understanding of all the requirements.

200 Overall objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

As explained above, the IAASB Clarity Project introduced significant structural changes to the ISAs and these are reflected in the ISAs (UK and Ireland), including:

- Describing an objective for each ISA, and
- Separating the requirements in each ISA from the application material.

ISA 200 has been revised to set out the overall objectives of the independent auditor, and explains the nature and scope of an audit designed to enable the independent auditor to meet those objectives. It also explains the scope, authority and structure of the ISAs, and includes requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the ISAs.

New requirements in ISA 200 make clear the purpose of the objectives that are now included in each of the other ISAs. These are that the auditor uses the objectives in planning and performing the audit, having regard to the interrelationships among the ISAs, to:

(a) Determine whether any audit procedures in addition to those required by the ISAs are necessary in pursuance of the objectives stated in the ISAs; and

(b) Evaluate whether sufficient appropriate audit evidence has been obtained. (Paragraph 21)

ISA 200 also includes material explaining important concepts related to an audit of financial statements. These include the premise on which an audit is conducted (including management's responsibilities), professional skepticism, professional judgment, and the inherent limitations of an audit, an understanding of which is necessary for a proper understanding of the conduct of an audit.

210 Agreeing the Terms of Audit Engagements

ISA 210 was not subject to a revision project in its own right but, nevertheless, has been significantly revised as a result of conforming changes stemming from the revision of other ISAs. In particular the auditor is required to perform specific procedures in order to establish whether the preconditions for an audit are present. These procedures include:

(a) Determining whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable. (Paragraph 6(a))

(b) Obtaining the agreement of management that it acknowledges and understands its responsibility (paragraph 6(b)):

    (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;

(ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(iii) To provide the auditor with:

a. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;

b. Additional information that the auditor may request from management for the purpose of the audit; and

c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

The revised ISA 580, Written Representations, requires the auditor to obtain written representations from management concerning the fulfillment of these responsibilities (see below).

260 Communication with Those Charged with Governance

The revision of ISA 260 is intended to reflect significant regulatory and auditing standards developments in several jurisdictions, and shifts in the expectations of those charged with governance and other stakeholders.

The IAASB drew heavily on the APB's extant ISA (UK and Ireland) 260 and many of the current APB supplementary requirements have now been adopted in substance in the revised standard. While the revision of ISA 260 brought it closer to the extant ISA (UK and Ireland) 260 there are several additional requirements that are currently covered in substance by guidance text in the extant ISA (UK and Ireland), including:

- Where applicable, explaining why significant accounting practices that are acceptable under the applicable financial reporting framework are not considered the most appropriate in the particular circumstances of the entity. (Paragraph 16(a))
- Documenting matters communicated orally. (Paragraph 23)

In addition there are new explicit communication requirements for the auditor, including:

- Significant difficulties, if any, encountered during the audit. (Paragraph 16(b))
- Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management (unless all those charged with governance are involved in managing the entity). (Paragraph 16(c))

265 Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

This is a new standard which is intended to enhance the quality of the auditor's communication of deficiencies in internal control identified by the auditor. The development of the standard was undertaken originally to clarify the meaning of "material weakness" in the light of:

- The requirement under the European Union's Statutory Audit Directive for auditors to report identified material weaknesses in internal control ("material weaknesses") to audit committees; and
- The U.S. Public Company Accounting Oversight Board's (PCAOB's) issuance of an auditing standard addressing an audit of internal control over financial reporting.

As the project evolved, new considerations emerged and the original aim of defining "material weakness" was shifted to a focus on developing a clear definition of the threshold of significance at which a "deficiency in internal control," including controls that are "missing," should be communicated to those charged with governance.

A "deficiency in internal control" exists when (paragraph 6(a)):

(i) A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or

(ii) A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

The standard includes requirements for the auditor to:

- Determine, on the basis of the audit work performed, whether, individually or in combination, identified deficiencies in internal control constitute 'significant deficiencies'. A significant deficiency is a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance. (Paragraphs 6(b) and 8)
- Communicate in writing all significant deficiencies to those charged with governance, including a description of the deficiencies and an explanation of their potential effects. (Paragraphs 9 and 11(a))
- Communicate to management:
  - in writing, significant deficiencies that the auditor has, or intends, to communicate to those charged with governance; (paragraph 10(a)) and
  - other deficiencies, that have not been communicated by other parties, that in the auditor's professional judgment are of sufficient importance to merit management's attention. (Paragraph 10(b))

320 Materiality in Planning and Performing an Audit

Since the issuance of the original ISA 320, "Audit Materiality," several national standard setters had revised and expanded their existing standards and guidance. In particular, there was increased recognition of the need for greater consideration not only of the size of an item, but also of its nature and of the circumstances of the entity when determining materiality and evaluating misstatements. Work undertaken by APB on aggressive earnings management also highlighted audit materiality as an important area.

Key areas the IAASB sought to address in the revision were:

- Updating the definition of materiality to make clearer that materiality depends on the size and nature of an item judged in the surrounding circumstances.
- Introducing guidance on the use of benchmarks for the initial determination of materiality (but not setting formulaic rules);
- Indicating that during the audit the auditor is alert for possible bias in management's judgments. When evaluating whether the financial statements as a whole are free of material misstatement, the auditor is required to consider both the uncorrected misstatements and the qualitative aspects of the entity's accounting practices.

Following that initial exposure, the IAASB concluded that the clarity and flow of the requirements and guidance would be enhanced by addressing materiality and misstatements in separate ISAs. This led to the creation of ISA 450, Evaluation of Misstatements Identified During the Audit (see separate section below).

With respect to materiality, the revision has introduced more requirements relating to the determination of materiality and related amounts, but does not specify a methodology (e.g. percentages) that should be applied.

The definition of materiality is replaced by a description of the common characteristics of materiality covered in financial reporting frameworks. It is made clearer that materiality depends on the nature of an item as well as its size.

The new requirements include:

- Determining a lower amount, 'performance materiality,' for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. (Performance materiality is the amount, or amounts, set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.) (Paragraphs 9 and 11)

How much less performance materiality is than materiality for the financial statements as a whole is a matter of judgment, affected by the auditor's understanding of the entity and the nature and extent of misstatements identified in previous audits and thereby the auditor's expectations in relation to misstatements in the current period.

- Determining whether a materiality amount lower than the materiality level for the financial statements as a whole is applicable for particular classes of transactions, account balances or disclosures (paragraph 10). For example, in the UK and Ireland, statutory disclosures related to directors' remuneration might be a particular class of transaction and disclosure where lower levels of materiality and performance materiality might be used.
- Revising materiality in the event of becoming aware of information that would have caused the auditor to determine a different amount initially. If the auditor concludes that a lower materiality for the financial statements as a whole than that initially determined is appropriate, the auditor is also required to determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the planned procedures remain appropriate. (Paragraphs 12 and 13)
- Specific documentation requirements for the amounts determined and any changes made during the audit. (Paragraph 14)

402 Audit Considerations Relating to an Entity using a Service Organization

The revision of ISA 402 was intended to respond to relevant developments, including:

(a) The increasing use of service organizations by entities and increasing complexity of such relationships; and

(b) The need to align the standard with the risk assessment standards, in particular those dealing with obtaining an understanding of internal control and the assessment of identified risks.

The revised ISA 402 is also intended to enhance the consistency of auditor performance in an audit of financial statements through more specific requirements and expanded guidance.

In addition to aligning the standard with the risk assessment standards, the revision increases the focus on, and expands the requirements and guidance, when the auditor intends to use a service auditor's report as audit evidence (in particular 'Type 2' reports, which cover the operating effectiveness of controls at a service organisation).

Requirements include:

- Specifying matters included in the understanding of how the user entity uses the services of a service organisation. (Paragraph 9)
- When the user auditor's risk assessment includes an expectation that controls at the service organization are operating effectively, specifying procedures the user auditor performs to obtain audit evidence about the operating effectiveness of those controls, including: (paragraph 16)
  - (a) Obtaining a Type 2 report, if available;
  - (b) Performing appropriate tests of controls at the service organization; or
  - (c) Using another auditor to perform tests of controls at the service organization on behalf of the user auditor.
- Specifying procedures to be performed if the user auditor plans to use a report from a service auditor as audit evidence, including:
  - o being satisfied as to the service auditor's professional competence and independence from the service organization, and the adequacy of the standards under which the report was issued; (paragraph 13) and
  - o in relation to Type 2 reports, procedures to determine whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment. (Paragraph 17)

450 Evaluation of Misstatements Identified During the Audit

As explained above, ISA 450 a new standard that has been derived from the revision of ISA 320 on audit materiality. There are a number of new requirements, although for most audits these are not expected to give rise to significant changes in current practice in the UK and Ireland. These include:

- Accumulating all misstatements identified other than those that are clearly trivial. (Paragraph 5)
- Prior to evaluating the effect of uncorrected misstatements, reassessing materiality determined in accordance with ISA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results. (Paragraph 10)
- Determining whether uncorrected misstatements are material, with consideration given to the nature of the misstatements as well as their size and to the effect of uncorrected misstatements related to prior periods. (Paragraph 11)
- Specific documentation requirements (paragraph 15):
  - (a) The amount below which misstatements would be regarded as clearly trivial;
  - (b) All misstatements accumulated during the audit and whether they have been corrected; and

(c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

505 External Confirmations

The revision of ISA 505 was intended to respond to the concerns of some stakeholders that more rigorous requirements governing the use of external confirmations by the auditor were required.

The revised standard relates to the 'how' of confirmations, not the 'when'. The new requirements are unlikely to result in significant changes of substance to current practice in the UK and Ireland. Compared to the extant ISA 505 there is more specification, in particular in relation to:

- Maintaining control over the confirmation requests. (Paragraph 7)
- Obtaining further evidence to resolve doubts about the reliability of responses. (Paragraph 10)
- Specifying conditions that have to be present if negative confirmations are used as the sole substantive audit procedure. (Paragraph 15)

A conforming change has been made to ISA 330, paragraph 19, to require that auditors consider whether external confirmation procedures are to be performed as substantive procedures, but, in substance, this is no change from the requirement in the extant ISA 505.

540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

Due to changes in accounting frameworks, financial statements contain more estimated amounts than when the ISAs were originally issued. The revision of ISA 540 was undertaken to improve the rigor of the auditing of estimates. The revision has also taken account of work undertaken by APB on aggressive earnings management that highlighted that management may be motivated to choose accounting estimates that affect the carrying amount of assets or liabilities as a means of managing earnings. Such motivation may result in financial statements that lack neutrality, or freedom from bias.

The principles and techniques for auditing estimates also apply to auditing fair values, and, indeed, it can be difficult to distinguish an estimate from a fair value. Following initial exposure, a decision was therefore made by IAASB to merge ISA 545, Auditing Fair Value Measurements and Disclosures, into ISA 540.

This revision introduces a number of new requirements which may cause current practice in the UK and Ireland to change. The revised standard:

- Introduces requirements for greater rigor and skepticism into the audit of accounting estimates, including the auditor's consideration of indicators of possible management bias. It also conforms the approach taken to the audit of accounting estimates with the audit risk and fraud standards.
- Provides standards and guidance on the auditor's determination and documentation of misstatements and indicators of possible management bias relating to individual accounting estimates.
- Focuses the requirements and guidance on auditing estimates on areas of estimation uncertainty and risk.
- Aligns the requirements and guidance on auditing fair values with the audit risk model, and improves them for matters covered as part of the revision of ISA 540 (e.g., use of ranges, indicators of possible management bias, etc.).

New requirements include:

- More specification regarding matters the auditor obtains an understanding of for the purpose assessing risks, including how management identifies those transactions, events and conditions that may give rise to the need for accounting estimates, and how management makes the accounting estimates. (Paragraph 8)
- Reviewing the outcome of accounting estimates included in prior period financial statements or, where applicable, their subsequent re-estimation for the purpose of the current period. (Paragraph 9)
- Evaluating estimation uncertainty and determining whether estimates with high levels of uncertainty give rise to significant risks. (Paragraphs 10 and 11)
- Requiring substantive procedures to respond to significant risks, including:
    - Evaluating how management has considered alternative assumptions or outcomes and why it has rejected them, or how it has otherwise addressed estimation uncertainty. (Paragraph 15(a))
    - Obtaining sufficient appropriate audit evidence about whether management's decisions to recognise, or not recognise, the estimates in the financial statements, and the selected measurement basis, are in accordance with the applicable financial reporting framework. (Paragraph 17)
    - Evaluating the adequacy of the disclosure of estimation uncertainty in the context of the applicable financial reporting framework. (Paragraph 20)
- Reviewing management's judgments and decisions to identify whether there are indicators of possible management bias. (Paragraph 21)

550 Related Parties

The IAASB was encouraged to update ISA 550 in response to a number of developments. In particular:

- The major corporate scandals of the recent past have highlighted that fraudulent financial reporting often arises through the involvement of related parties.
- Following the issue of the audit risk standards, there was a need to revise the extant ISA 550, which is mainly procedural, to focus more on the identification and assessment of risks of material misstatement associated with related party relationships and transactions, and performing appropriate procedures to respond to such risks.

The revised ISA places greater emphasis on a risk based approach to the consideration of related parties. It also seeks to improve auditor performance with the difficult task of identifying related party relationships and transactions not disclosed to them by management.

New requirements include:

- Specifying that the audit team discussion required by ISA 315 shall include consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions. (Paragraph 12)
- Obtaining an understanding of the controls, if any, that management has established, including to (paragraph 14):
  - Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;
  - Authorize and approve significant transactions and arrangements outside the normal course of business.
- Treating identified significant related party transactions outside the entity's normal course of business as giving rise to 'significant risks.' (Paragraph 18)
- Specifying procedures to be performed if the auditor identifies related parties or significant related party transactions that management has not previously disclosed to the auditor. (Paragraph 22)
- Specifying procedures to be performed for identified significant related party transactions outside the entity's normal course of business, including (paragraph 23):
  - Inspecting the underlying contracts or agreements, if any, and evaluating whether:
    - the business rationale, or lack thereof, of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets
    - the terms of the transactions are consistent with management's explanations; and
    - they have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework

- Obtaining audit evidence that the transactions have been appropriately authorised and approved.

- If management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor shall obtain sufficient appropriate audit evidence about the assertion. (Paragraph 24)
- Communicating with those charged with governance about significant matters identified arising during the audit in connection with the entity's related parties. (Paragraph 27)
- Documenting the names of identified related parties and the nature of related party relationships. (Paragraph 28)

580 Written Representations

The revision of the extant ISA 580, "Management Representations," was intended to respond to relevant developments, including concerns that auditors may be over relying on written representations.

The revised standard introduces a number of significant changes. To address the original concern that auditors may be over relying on written representations it is made clearer that, although written representations provide necessary audit evidence, they support other audit evidence obtained and do not on their own provide sufficient appropriate audit evidence about any of the matters with which they deal.

Changes include:

- Requiring auditors to obtain written representations about management's responsibilities, including:
    - that management has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement; (paragraph 10)
    - that management has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement; (paragraph 11(a)) and
    - all transactions have been recorded and are reflected in the financial statements. (Paragraph 11(b))
- If management does not provide the written representations acknowledging its responsibilities the auditor is required to disclaim an opinion on the financial statements. (Paragraph 20(b))

To support these new requirements conforming changes have been made to ISA 210 establishing preconditions for an audit, including obtaining management's agreement that it understands and acknowledges its responsibility for the matters to which these representations relate (see above).

600 Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)

The IAASB revised ISA 600, “Using the Work of Another Auditor,” in response to requests from several bodies for guidance on the audit of group financial statements, including the European Commission, the International Organization of Securities Commissions, the former Panel on Audit Effectiveness in the United States, and the International Forum on Accountancy Development. The revision establishes requirements and guidance on matters relevant to the audit of group financial statements that were not covered in existing ISAs.

The IAASB concluded that increased specification of procedures to be performed is necessary to achieve greater consistency in group audit practices where the group auditor takes sole responsibility and consequently the revised ISA introduces a number of new requirements that the group auditor needs to undertake, particularly when other auditors audit group components. These requirements strengthen the direction of the audit by the group auditor and the group auditor’s involvement in the work of component auditors. However, the impact of the new requirements will be less for the audit of groups with only a small number of components and where the audit work on these is undertaken by the same engagement team – in such cases the requirements applying when other auditors undertake the work on a component and many of the conditional requirements will not apply.

Matters covered by the requirements include:

- Acceptance and continuance as group auditor (including, where component auditors will be involved, consideration of whether the group engagement team will be able to be involved in the work of the component auditor to the extent necessary to obtain sufficient appropriate audit evidence). (Paragraphs 12-14)
- Overall audit strategy and audit plan. (Paragraphs 15-16)
- Obtaining an understanding of the group, its components, and their environments, including group-wide controls, and assessing the risks of material misstatement of the group financial statements. The existence of strong group-wide controls can lead to a reduced need for audit evidence on components that are not individually significant. (Paragraphs 17-18)
- Obtaining an understanding of component auditors, including their professional competence and whether they understand, and will comply with, the ethical requirements that are relevant to the group audit. (Paragraphs 19-20)
- Materiality (paragraphs 21-23). The group engagement team is required to determine (paragraph 21):
    - The materiality level for the group financial statements as a whole; and

- If the group auditor determines that in the specific circumstances of the group, there are particular classes of transactions, account balances or disclosures in the group financial statements for which misstatements of lesser amounts than the materiality level for the group financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements, the materiality levels to be applied to those particular classes of transactions, account balances or disclosures.
- Component materiality for those components where component auditors will perform an audit or a review for purposes of the group audit (unless the auditor intends to rely on a statutory audit), and
- The threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements.

- Responding to assessed risks (paragraphs 24-31), including determining:
    - the work to be performed on the financial information of components.
        - For a component that is of individual financial significance an audit of the financial information, using component materiality, is required. (Paragraph 26)
        - For a component that is significant because it is likely to include group level significant risks one or more of the following is required (paragraph 27):
          (a) An audit of the financial information of the component using component materiality.
          (b) An audit of one or more account balances, classes of transactions or disclosures relating to the likely significant risks of material misstatement of the group financial statements.
          (c) Specified audit procedures relating to the likely significant risks of material misstatement of the group financial statements.
        - For non-significant components analytical procedures at group level are required. Further procedures are specified if more audit evidence needs to be obtained on which to base the group audit opinion. (Paragraphs 28 and 29)
    - the level of involvement of the group engagement team in the work performed by component auditors. For significant components the group engagement team is required to be involved in the component auditor's risk assessment to identify significant risks of material misstatement of the group financial statements. (Paragraph 30)
- Consolidation process. (Paragraphs 32-37)
- Subsequent events. (Paragraphs 38-39)
- Communication with component auditors (including details of matters to be covered). (Paragraphs 4041)

- Evaluating the sufficiency and appropriateness of audit evidence obtained. (Paragraphs 42-45)
- Communication with group management and those charged with governance of the group. (Paragraphs 46-49)
- Documentation, including (paragraph 50):
  - An analysis of components, indicating those that are significant, and the type of work performed on the financial information of the components.
  - The nature, timing and extent of the group engagement team's involvement in the work performed by the component auditors on significant components including, where applicable, the group engagement team's review of relevant parts of the component auditors' audit documentation and conclusions thereon.
  - Written communications between the group engagement team and the component auditors about the group engagement team's requirements.

620 Using the Work of an Auditor's Expert

The IAASB revised ISA 620 in response to developments including:

(a) A concern that the extant ISA 620 mainly focuses on the use of experts with respect to substantive procedures regarding the measurement of account balances, whereas experts may be used for other purposes during the audit, for example, to assist in identifying and assessing the risks of material misstatement; and

(b) The possibility that the wider use of fair value accounting may require more frequent use of experts by the auditor.

During the project, the IAASB considered matters, including whether the auditor's report should refer to the expert, and how the nature, timing and extent of audit procedures varies depending on such matters as: the nature of, and risks of material misstatement in, the matter to which the expert's work relates; the significance of the expert's work in the context of the audit; the auditor's knowledge of and experience with previous work performed by the expert; and whether the expert is subject to the auditor's firm's quality control policies and procedures.

The scope of the revised standard is restricted to consideration of the auditor's use of the work of an expert, employed or engaged by the auditor, possessing expertise in a field other than accounting or auditing. Conforming amendments have been made to paragraph of ISA 500, "Audit Evidence," so that it addresses use of management's experts. Considerations where a member of the engagement team with expertise in a specialized area of accounting or auditing is used are addressed in paragraph A20 of ISA 220, "Quality Control for an Audit of Financial Statements."

Compared to the extant ISA there is more specification of audit procedures, in particular regarding the agreement of work to be performed (paragraph 11) and evaluating the reasonableness of the expert's findings (paragraphs 12 and 13).

Appendix

List of Auditing Standards and Whether Revised as well as Clarified

The new ISAs (UK and Ireland) incorporate the clarified ISAs issued by the International Auditing and Assurance Standards Board (IAASB), with the exception of ISA 700 (see page 3 above).

Standard		Revised as well as clarified
International Standard on Quality Control		
1	Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements	
International Standards on Auditing		
200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK and Ireland)	✓
210	Agreeing the Terms of Audit Engagements	✓[3]
220	Quality Control For an Audit of Financial Statements	
230	Audit Documentation	
240	The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements	
250A	Consideration of Laws and Regulations in an Audit of Financial Statements	
250B	The Auditor's Right and Duty to Report to Regulators in the Financial Sector	
260	Communication with Those Charged with Governance	✓
265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management	**New standard**

[3] ISA 210 was not subject to a revision project in its own right but, nevertheless, has been significantly revised as a result of conforming changes stemming from the revision of other ISAs.

300	Planning an Audit of Financial Statements	
315	Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment	
320	Materiality in Planning and Performing an Audit	✓
330	The Auditor’s Responses to Assessed Risks	
402	Audit Considerations Relating to an Entity Using a Service Organization	✓
450	Evaluation of Misstatements Identified During the Audit	**New standard**
500	Audit Evidence	
501	Audit Evidence – Specific Considerations for Selected Items	
505	External Confirmations	✓
510	Initial Audit Engagements – Opening Balances	
520	Analytical Procedures	
530	Audit Sampling	
540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures	✓
550	Related Parties	✓
560	Subsequent Events	
570	Going Concern	
580	Written Representations	✓
600	Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)	✓
610	Using the Work of Internal Auditors	
620	Using the Work of an Auditor’s Expert	✓

700	Forming an Opinion and Reporting on Financial Statements[4]	
705	Modifications to Opinions in the Independent Auditor's Report	✓[5]
706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	✓[5]
710	Comparative Information – Corresponding Figures and Comparative Financial Statements	
720A	The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements	
720B	The Auditor's Statutory Reporting Responsibility in Relation to Directors' Reports	

4 APB has not adopted ISA 700, "Forming an Opinion and Reporting on Financial Statements," as issued by the IAASB. It has instead issued a clarified version of the recently revised ISA (UK and Ireland) 700, "The Auditor's Report on Financial Statements" (see page 3 above).

5 ISAs 705 and 706 separate and revise the requirements and guidance in current ISA 701, "Modifications to the Independent Auditor's Report." APB has not adopted ISA 701 – for the UK and Ireland, requirements and guidance relating to modification of the auditor's report are currently included in ISA (UK and Ireland) 700 (Revised). As explained on page 4 above, APB is now adopting ISAs 705 and 706.

NOTICE TO READERS

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